Proposed Change to VITA Rate Structure Methodology

For presentation to the ITIB on March 3, 2004

Outcome Desired: Finance Committee and ITIB approval on proposed change to VITA rate structure methodology for new services

Background: VITA developed interim rates for new IT services that were approved by JLARC at its December 2003 meeting, with certain conditions. These rates were based upon a fully transformed organization that would recover costs associated with bringing all VITA customers to specified levels of support for staffing, maintenance, licensing, help desk, security and equipment replacement services. The rates did not assume any savings offsets that would help reduce the overall cost of providing these services to VITA customers.

Once the December 2003 approved rates were published, agencies began a comparison of their existing IT expenditures compared to projected expenses based on these rates. While not all comparisons were on an apples-to-apples basis, it was evident that the new VITA rates would result in increased costs to agencies beyond their ability to pay.

Current direction: Based upon what has been learned from the agencies regarding the interim rates for new services, VITA is recommending a change in approach to its interim rate methodology. This change is consistent with the CIO's direction to concentrate solely on transition activities over the coming year.

The guiding principles for the proposed rate structure methodology are as follows:

- Rates must be fair
- Rates must be reasonable
- Compliance requirements related to Commonwealth IT practices, such as legal licenses for all software, must be met
- Total costs of in-scope IT services must be within the scope of agencies ability to pay

Based upon these principles, VITA is proposing that we use a "cost-plus" approach to IT services. Agencies will only pay for services they request—and approve—and VITA will bill the agencies for those direct costs plus an administrative, or overhead, fee. The only other additional cost to the agency will be related to any compliance requirements, which VITA will require the agency to pay.

The administrative fee will be based upon the necessary essential overhead to make the integration happen, primarily additional finance, contract/procurement and human resources staff and service level director needs to manage the distributed sites, and some planning or "swat team" staff to identify and go after the low hanging fruit we need to build external confidence in our ability to save money along the way. New initiatives, like server consolidation, will be treated as a new initiative and will stand on their own from an ROI perspective at the time we evaluate the opportunity.

Unlike the December 2003 interim rates, the proposed methodology does not include credits for IT equipment transferred to VITA. Credits were being provided under the interim rates because equipment replacement costs were factored into those rates. The proposed rates will not include any replacement costs and, therefore, credits are unnecessary.

Once approved by the IT Investment Board, the proposed rate methodology will be presented to the Auditor of Public Accounts and JLARC staff for review. VITA will then proceed to develop a formal rate request to JLARC for approval at its May 2004 meeting, unless an earlier meeting is announced whereby VITA would seek approval at that time. A draft timeline for submission of the proposed rates to JLARC is at Attachment 1.

Impact on Agencies: VITA was prepared to issue bills to small agencies that transitioned in the last quarter of 2003 based upon the approved interim rates. Based upon the new approach, VITA will not bill small agencies based on those rates and will seek JLARC approval to make the new rates retroactive to November 2003. The effect on small agencies is that they will not receive bills for services provided by VITA until JLARC approves the new rate structure. As discussed above, their bills will be based upon actual costs incurred plus any compliance costs plus the approved administrative fee. We believe these costs will be within the agencies "ability to pay."

We have also made decisions to move the on-boarding date of all medium agencies and VDOT to July 1, 2004. This action will eliminate any financial impact on the medium agencies during FY 2004. Large agencies will still transition during the fall 2004 timeframe as previously planned. As with the small agencies, we believe our methodology will result in costs that are within the medium and large agencies ability to pay.

Potential Issues: VITA has identified issues related to the proposed methodology that are related to small agency funding availability, small agency costs already incurred, federal equipment transfers, and the proposed administrative fee.

JLARC staff has raised a concern that due to the lateness in the fiscal year of any JLARC approval of our proposed methodology those small agencies will not have reserved funds to pay for VITA bills retroactively to when they were on-boarded. We are working to address this concern with the small agencies as quickly as possible.

There have also been changes to the small agency IT environment as a result of transition activities, with resultant related costs, that may increase costs to small agencies that are outside their ability to pay. VITA is currently identifying those costs and will work with the small agencies to identify any financial impact.

VITA is continuing to address federal equipment transfer issues with agencies. The agency meetings currently being held by FMS are identifying potential issues which must be addressed prior to transitioning medium and large agencies.

Finally, agencies will be opposed to the proposed administrative fee, seeing it as an additional cost that they have to incur. VITA is investigating an approach whereby we target an amount of savings that is equal to the amount of the proposed fee and pass the savings along to the agency, effectively negating the amount of the administrative fee. We are assessing how this strategy would work in reality to provide savings in an amount equal to the proposed fee.

Attachment 1

Draft Timeline for Submission of Proposed Rates to JLARC February – March, 2004	
February 25	Discussion of New Rate Methodology with APA
February 26	Propose New Rate Methodology to the ITIB Finance Committee .
February 28	Discussion of New Rate Methodology with JLARC .
March 3	Propose New Rate Methodology to ITIB .
March 12	Decisions made on Approach to HHS
March 15	CIO Update on Draft Proposal to JLARC
March 18	CIO Approval of JLARC Submission .
March 22	Formal submission of Proposed Rates to JLARC